STRIKING A BALANCE BETWEEN PROTECTING INVESTORS AND PROMOTING SMALL BUSINESS: THE NEW RULE 506, ACCREDITED INVESTOR STANDARDS, AND THE GUIDELINES OF GENERAL SOLICITATION

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I. INTRODUCTION

Arguably, one of the most important steps in the development of a startup or small business is getting access to adequate capital. As one writer for Forbes put it, "[t]he first sentence in the job description of every CEO should be, 'Get the capital your company needs.'"[1] A business can satisfy its needs for capital through one of several avenues such as taking on debt or seeking out investors through personal relationships.[2] However, these avenues may not provide for all of the capital that a growing business needs. In some situations, the sale of securities can provide a large amount of capital to a small business.[3] The issuance of securities must comply with the various federal and state securities laws, which can be onerous for a new company, and the cost of raising capital must be accounted for no matter what process is used. A primary goal of any environment that is designed to promote small business creation and growth is providing access to adequate capital. Regulation D under the Securities Act of 1933 provides several avenues for a small business to offer securities to investors, while, at the same time, minimizing the cost of the offering by exempting the transaction from many of the more costly aspects of selling securities through

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[1] Jim Blasingame, *Three Fundamentals of Small Business Capitalization*, FORBES (May 12, 2014, 11:00 AM), http://www.forbes.com/sites/jimblasingame/2014/05/12/three-fundamentals-of-small-business-capitalization/.

[2] *See Small Business and the SEC: A Guide For Small Business on Raising Capital and Complying with the Federal Securities Laws*, SEC (Oct. 10, 2013), http://www.sec.gov/info/smallbus/qasbsec.htm#capital.

[3] *See, e.g.*, Vladimir Ivanov & Scott Bauguess, *Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009-2012*, SEC DIVISION OF ECONOMIC RISK AND ANALYSIS (July 2013), http://www.sec.gov/divisions/riskfin/whitepapers/dera-unregistered-offerings-reg-d.pdf.

traditional methods such as an initial public offering.[4] Specifically, SEC Regulation D provides a few major exceptions to the filing requirements under federal law.[5]

Rule 506 of Regulation D has drawn a lot of attention lately, as Congress, the SEC, issuers and investors grapple with the how best to promote small business capital formation while still protecting the investors that those businesses rely on. In some ways the changes to Rule 506 highlight the actual steps that the federal government can take to enhance small business capital formation by opening private placements to a larger pool of potential investors. However, the ongoing debate and continued proposals for change show the lack of consensus in how best to achieve an environment that is good for small businesses and investors.

One particular source of debate centers on where demo days fit into the regulatory structure. A demo day is typically an event where companies mostly discuss their products or services without necessarily an explicit expectation that the companies will discuss any proposed or ongoing capital raising transaction or will receive any investment.[6] Demo days often take the form of extremely short presentations by startups to investors that are organized by accelerators or incubators (venture capital funds whose main goal is to increase the odds of building a successful business sometimes in return for a small amount of equity).[7] For example Y Combinator and StartX both routinely put on demo days for companies that they have invested in and helped grow up to that point. These events involve presentations by each company, as short as two minutes each, where the company will try to market itself to a room of investors and press. Some of the recent success stories from to come out of Y Combinator were DropBox in 2007 and AirBnB in 2009.[8] Regardless of the success of the startups coming out of demo

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[4] *See generally* PRICEWATERHOUSECOOPERS, CONSIDERING AN IPO? THE COSTS OF GOING AND BEING PUBLIC MAY SURPRISE YOU (2012).

[5] 17 C.F.R. § 230.500 (2013).

[6] Joseph M. Wallin, *General Solicitation and Start-up Capital Raising: Existing Guidance and New Questions*, Thomson Rueters Practical Law Corporate & Securities 5, http://www.startuplawblog.com/wp-content/uploads/2013/11/General-Solicitation-and-Startup-Capital-Raising.pdf.

[7] Mark Lennon, *The Startup Accelerator Trend is Finally Slowing Down*, TECHCRUNCH (Nov. 19, 2013), http://techcrunch.com/2013/11/19/the-startup-accelerator-trend-is-finally-slowing-down/; Y Combinator's standard deal for helping a startup is $120,000 for 7% of the company's equity (https://www.ycombinator.com/faq/). Not all accelerators take an equity stake in the businesses they support. For instance, StartX is an accelerator program that provides access to a fund that partners with Stanford University and takes no equity as a matter of policy (http://startx.stanford.edu/accelerator).

[8] Nick Gonzalez, *Y Combinator Demo Day: The Summer Startups*, TECHCRUNCH, (Aug. 16, 2007) http://techcrunch.com/2007/08/16/y-combinator-demo-day-the-summer-startups/; Leena Rao, *Y Combinator Demo Day Spring 2009*,

days, their place within the Regulation D structure was never fully settled. This issue has caused much confusion, and will serve as a focusing tool in the further discussion of the changes to Regulation D.

This Note will examine the recent changes to Rule 506 and Regulation D, what other measures have been proposed, and what changes should come in the future. The focus will be on the standards determining who is an accredited investor, and what is general solicitation under the present regulatory structure. Section II is a review of Regulation D and private placements. Section III looks at the competing interests behind why the exempted offering rules were changed and reasons why other attempts at change have not succeeded as of yet. Section IV outlines a proposal for how Congress and the SEC could act to bridge the gap between the stated concerns of its members and those of the businesses and investors that they are tasked with supporting. Specifically, the SEC should update the accredited investor definition to better represent the nature of modern investors and the protection that these individuals actually require, and better identify the scope and limits of the general solicitation allowance.

II. PRIVATE PLACEMENTS

A. Origins

The Securities Act of 1933 imposes many requirements on the sale of securities, and a corporation will incur significant costs in meeting these requirements.[9] The time and expense that go into an IPO will foreclose many small and emerging businesses from raising capital by selling securities through this process.[10] The SEC responded to this issue in 1982 by promulgating Regulation D, which consisted of six rules that exempt certain limited offerings of securities from SEC registration that was required by section 5 of the Securities Act.[11] Regulation D expanded and unified the previous exemption structure, while still staying within the safe harbor provision of Section 4 of the Securities Act.[12] Regulation D created rules 504, 505, and 506 as a replacement to

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TECHCRUNCH, (Mar. 18, 2009) http://techcrunch.com/2009/03/18/y-combinator-demo-day-spring-2009/.

[9] Securities Act of 1933, 15 U.S.C. § 77a *et seq.* (YEAR). The costs associated with going public vary widely and increase as a company's revenue increases, with the average cost for a company with revenues of less than $100 million averaging about $11.5 million. PRICEWATERHOUSECOOPERS, *supra* note 4, at 8.

[10] *See* Manning Gilbert Warren III, *A Review of Regulation D: The Present Exemption Regimen for Limited Offerings Under the Securities Act of 1933*, 33 AM. U. L. REV. 355 (1982).

[11] *Id.* at 357.

[12] *Id.* at 358–59; *see also* Securities Act of 1933 § 4, 15 U.S.C. § 77d (2012).

rules 240, 242, and 146.[13]

Prior to 2012, Regulation D consisted of three substantive rules for exempting the offer and sale of securities from the registration process.[14] Specifically, Rules 504, 505 and 506 set forth the required elements of the three main types of private placements. Rule 504 private placements must not exceed $1,000,000 and are subject to state securities law.[15] Rule 505 private placements must not exceed $5,000,000 and are limited to 35 purchasers.[16] Rule 506 offered the least amount of restrictions out of the three, as the only restriction was on the amount of non-accredited investors allowed.[17] Regulation D's three other rules, 501, 502 and 503, set forth the general requirements, definitions, terms, and conditions for the operative provisions, including the standards for an accredited investor and a ban on the use of general solicitation.[18]

Rule 501(a) provides the definition of who is an accredited investor.[19] The rule sets out separate accreditation requirements for certain institutions and individuals. For instance, an individual with a net worth of over $1,000,000 or an income of over $200,000 for the past two years with a reasonable belief that this level of income will continue is deemed accredited (subject to certain adjustments such as if the person files jointly with a spouse).[20] The accreditation standards are designed to protect investors by limiting access to exempted offerings to only those that are deemed to be able to handle the risk involved in exempted offerings.[21]

The ban on general solicitation is very broad, and the exceptions included within the rules are narrow. The rules speak to a ban on the use

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[13] Warren, *supra* note 10, at 357–58.
[14] *See* 17 C.F.R. § 230.504 *et seq.* (2012).
[15] *Id.* § 230.504.
[16] *Id.* § 230.505.
[17] *Id.* § 230.506.
[18] The main provisions at issue are 17 C.F.R. § 230.501(a) (2013) (defining "accredited investor") and 17 C.F.R. § 230.502(c) (2013) (banning general solicitation or advertising).
[19] *Id.* § 230.501(a).
[20] *Id.* The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 altered the definition of accredited investor by excluding the value of an individual's primary residence from the calculation of the individual's net worth in 17 C.F.R. § 230.501(a)(5)(i)(A). Net Worth Standard For Accredited Investors, Securities Act Release No. 33-9287 (Dec. 21, 2011).
[21] The reasoning for the accredited investor standard comes from the same distinction between public and private offerings. In *SEC v. Ralston-Purina*, the Supreme Court held that the availability of the exemption from registration and disclosure requirements "should turn on whether the particular class of persons affected needs the protections of the Act. . . . An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering.'" S.E.C. v. Ralston Purina Co., 346 U.S. 119, 125 (1953); *see also* Nonpublic Offering Exemption, Securities Act Release No. 33-4552 (Nov. 6, 1962).

of both general solicitation and general advertising in the offering or sale of securities. Rather than provide a definition for general solicitation, the rule is based on the inclusion of what the SEC calls examples.[22] The rules lay out general solicitation and general advertising in this particular section as a non-exclusive list of what constitutes general solicitation and general advertising.[23] The listed items include "Any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio."[24] The rule then goes on to include "[a]ny seminar or meeting whose attendees have been invited by any general solicitation or general advertising."[25] These two operative clauses are the entirety of the listed items that are included in the stated ban on general solicitation.

The SEC staff used the broad examples in the rule to offer interpretations as questions arise.[26] Since general solicitation was first laid out in Regulation D, the SEC staff has relied upon the idea of preexisting relationships to interpret whether an action constitutes general solicitation.[27] Many of the no action letters that the SEC staff issued dealing with general solicitation at that time focused on the fact of whether there existed a prior relationship between the issuer and the investor that would allow the investor a better opportunity to make an informed decision.[28]

The rule also includes two exceptions to the general ban, besides the actual private offerings that are not subject to the ban after 2013.[29] The first allows an issuer to publish a limited notice of certain filings with the SEC,[30] and the second allows for journalist access to certain press conferences and meetings conducted or released outside of the United States.[31] Outside of the exception for a notice of sales on Form D, the other listed exceptions require compliance with regulations that are both

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[22] Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, 78 Fed. Reg. 44,771, 44,773 (July 24, 2013) (to be codified at 17 C.F.R. pt. 230, 239, and 242).

[23] Although 17 C.F.R. § 230.502(c) addresses both general solicitation and general advertising, it is often referred to as the ban on general solicitation. Therefore, when general solicitation is hereinafter referenced, it is inclusive of general advertising rather than apart from it. 17 C.F.R. § 230.502(c)(1)(2013).

[24] *Id.* § 230.502(c)(1).

[25] *Id.* § 230.502(c)(2).

[26] Eliminating the Prohibition, *supra* note 22, at 44,773.

[27] Interpretive Release on Regulation D, 48 Fed. Reg. 10,045, 10,052 (Mar. 10, 1983).

[28] *See* David D.H. Martin Jr. & L. Keith Parsons, *The Preexisting Relationship Doctrine Under Regulation D: A Rule Without a Reason*, 45 WASH. & LEE L. REV. 1031, 1041–43 (1988); Courts have also utilized the preexisting relationship doctrine. Mark v. FSC Sec. Corp., 870 F.2d 331 (1989).

[29] *See* 17 C.F.R. § 230.506(c) (2013).

[30] *See id.* § 230.135(c).

[31] *See id.* § 230.135(e).

written for the purposes of Section 5 of the Securities Act dealing with prohibitions relating to interstate commerce and the mails.

As a comparison, within the group of regulations specifically for the purpose of this section of the Securities Act, 17 CFR 230.135a provides a definition for generic advertising that would not be deemed to constitute an offer any security for sale. This definition is comprehensive rather than a non-exclusive list, and allows for communication of broad level information about investment companies and the general nature of their securities.[32] While the allowances for generic advertising cater to a different need than those of general solicitation in 17 CFR 230.502(c), the main takeaway is the contrast in the style of the rule. Generic advertising is concretely defined in one, while the boundaries of general solicitation and general advertising are left to the interpretation of the SEC in the other. For example, the SEC gave some guidance on the use of the internet in connection with the ban on general solicitation.

The SEC issued an interpretation in 1995 that included the Commission's view "that the use of electronic media should be at least an equal alternative to the use of paper-based media. Accordingly, issuer or third party information that can be delivered in paper under the federal securities laws may be delivered in electronic format."[33] Among the documents included in the SEC's consideration were disclosure documents required in Rule 505 and 506 offerings, but the SEC cautioned issuers to be "mindful of the current prohibition in Rules 505 and 506 regarding general solicitation."[34] To aid issuers, the SEC included an example for applying the interpretation's principles to issuers selling stock through a Rule 506 private placement.[35] In this hypothetical, the SEC stated that if a company puts its offering materials on a website, even if the site requires information to be sent to the company from the person attempting to access the information prior to displaying the offering materials, it would be inconsistent with the ban on general solicitation.[36] However, "[w]here prospective purchasers have been otherwise located without a general solicitation, a proprietary computer service could be used to deliver required disclosure documents."[37] Furthermore, a company can transmit the offering materials to email addresses supplied by individuals it has located without using general solicitation without violating the ban on general

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[32] *See id.* § 230.135(a).
[33] Use of Electronic Media For Delivery Purposes, SEC Release No. 33-7233, 1995 WL 588462, 6 (Oct. 6, 1995).
[34] *Id.* at 3 n.9.
[35] *See id.* at 17.
[36] *Id.*
[37] *Id.*

solicitation.[38]

The next year, the SEC staff issued a no-action letter that the posting of a notice of a private offering would not be taken as general solicitation when the notice was in a password-protected page of the website that was accessible only to the site's members who had previously qualified with the website to be an accredited investor.[39] The SEC confirmed the staff's view that other use of available media, such as unrestricted web sites, is general solicitation.[40] These are just some examples of ways in which the SEC and its staff look to offer a more complete picture of the rules and regulations. Whereas these past interpretations were at the request of individuals or on the initiative of the SEC, the recent changes stem from a Congressional mandate.

B. Recent Developments

The Jumpstart Our Business Startups Act (JOBS Act) of 2012 changed Rule 506 by creating two separate situations where an offering will fit under the exemption. Title II of the JOBS Act, entitled Access to Capital for Job Creators, transformed Rule 506 through a few key changes.[41] Specifically, the JOBS Act mandated that the SEC must revise Rules 502 and 506 to allow general solicitation for Rule 506 offerings when the issuer had taken reasonable steps to verify that all of the potential investors were accredited.[42]

The SEC responded in July 2013 by finalizing rules that went into effect that September to put the congressional mandate into effect.[43] The new rules essentially created a new form of exempted transaction under Rule 506.[44] Rule 506(b) mirrors the old Rule 506, but Rule 506(c) now stands as a separate form of offering. There are three main differences between Rule 506(b) and Rule 506(c). In a Rule 506(c) offering: 1) all of the investors must be accredited, 2) the issuer must take reasonable steps to verify the accreditation of the investors, and 3) the issuer can engage in general solicitation.

Specifically looking at the second difference, the language of Rule 506(b) merely requires that an issuer have a reasonable belief that an investor is accredited.[45] However, Rule 506(c) requires an issuer to

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[38] *Id.*
[39] IPONET, SEC No-Action Letter, 1996 WL 431821, 1 (July 26, 1996).
[40] Eliminating the Prohibition, *supra* note 22, at 44,773 n.26 (citing Use of Electronic Media, *supra* note 33).
[41] Jumpstart Our Business Startups Act of 2012, Pub. L. No. 112-106, 126 Stat 306, § 201 (2012).
[42] *Id.*
[43] *See* Eliminating the Prohibition, *supra* note 22, at 44,771.
[44] 17 C.F.R. § 230.506 (2013).
[45] *Id.* § 230.506(b)(2)(i).

"take reasonable steps to verify that purchasers . . . are accredited investors."[46] The rule further provides a non-exclusive list of methods to verify accreditation. The SEC has offered some further guidance in compliance and disclosure interpretations as to how an issuer may verify the accreditation status of potential investors,[47] but the process remains somewhat hazy. The SEC viewed the new verification model as adequately addressing the changes that were mandated in the JOBS Act while still maintaining flexibility.[48]

The final difference does not come explicitly from Rule 506's modified language. Rather, the operative language was found in Rule 502(c), which specifically carves out Rule 506(c) from the limitations on general solicitation or general advertising.[49] General solicitation can be vitally important to a new business that requires access to more capital than the personal networks of the business owners allow. Thus a small business can seek out ideal investors to help reach its goals. Although the investors must be accredited, this requirement does not necessarily hamper this process. At least one commentator believed that: 1) accredited investors are more likely to have the means to invest than non-accredited investors thereby allowing a company to reach its goals with fewer investors, 2) accredited investors are less likely to attempt to exert influence over the business, and 3) an accredited investor is more likely to be able to introduce other investors to the company.[50] Broadening the pool through general solicitation may be vitally important to whether a business can get what it needs to succeed.

C. Usage

A quick look at the numbers displays the large market for private offerings. The values should only be thought of as an illustration of the market because, although the amounts are properly counted, comprehensive values are difficult for this market.[51] The exempted offering system was used extensively prior to these rule changes. A study from the Division of Economic and Risk Analysis (DERA) of the

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[46] *Id.* § 230.506(c)(2)(ii).
[47] SEC Staff Compliance and Disclosure Interpretations: Securities Act Rules (Questions 255.48, 255.49, 260.35, 260.36, 260.37, 260.38) (July 3, 2014), http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.
[48] Eliminating the Prohibition, *supra* note 22, at 44,776.
[49] 17 C.F.R. § 230.502(c) (2013).
[50] *Deal Marketing on the Internet The Outlook for 2014*, DEALFLOW 4-6 (Jan. 2014), http://dealflow.com/whitepapers/Dealflow_White_Paper_Q4_2013.pdf. The efficacy of this system may be muted to some extent by the need to take reasonable steps to verify the accreditation status of a potential investor.
[51] *See, e.g.*, Eliminating the Prohibition, *supra* note 22, at 44,788 (limiting economic analysis to what has been disclosed on Form D, which may not be wholly representative of the entire market).

SEC reported totals of $595 billion raised in 2009, over $1 trillion raised in 2010, $863 billion raised in 2011, and $903 billion raised in 2012 through exempted offerings.[52] The study further revealed that offerings under the previous version of Rule 506 accounted for 94% of Regulation D offerings between 2009 and 2012 and 99% of reported capital raised during that same time period.[53] Between 2009-2012, the average Regulation D offering was about $30 million, while the median offering size was about $1.5 million.[54] This difference between the average and the median size indicates that the exempted offering market is composed of many smaller offerings, which according to the SEC is "consistent with the view that many smaller businesses are relying on Regulation D to raise capital..."[55]

The JOBS Act changes to Rule 506 offerings were designed to make it easier for small businesses to access the capital they need, but issuers have been somewhat hesitant to utilize Rule 506(c) offerings. Between the middle of the third quarter of 2013, when the rules went into effect, and December 2013, approximately 270 issuers told the SEC that they were offering under 506(c) with an aggregate value of $3.7 billion.[56] By March 2014, Keith Higgins, the Director of the SEC Division of Corporate Finance, announced that 900 offerings had taken place under 506(c), which had raised more than $10 billion. During the same period, over 9,200 offerings were conducted under 506(b)—the old rule 506—and these new offerings resulted in the sale of over $223 billion in securities.[57] Thus, although large amounts had been raised during this time, there was not large-scale shift to the new private offering structure. Perhaps it is still too early in the process for the effects to be felt, but the numbers at least provide some context for the discussion.

III. COMPETING INTERESTS AND CONFUSION IN THE SEC

A. Varying Policies

Issuers and investors are not the only groups to cast a wary eye on the new regulations, debate has flourished over whether the new regulations go far enough, or too far, in promoting small business capital formation. Essentially, the concern over the proposed and adopted rules rested on the fundamental struggle between promoting small businesses

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[52] Ivanov and Baugess, *supra* note 3, at 4.
[53] *Id.* at 7.
[54] *Id.* at 5.
[55] Eliminating the Prohibition, *supra* note 22, at 44,790.
[56] Dealflow, *supra* note 49, at 7.
[57] Keith F. Higgins, Sec. & Exch. Comm'n, Keynote Address at the 2014 Angel Capital Association Summit (March 28, 2014).

and protecting the investors that these businesses rely on.

The Securities Act came during the Great Depression in part to protect investors through disclosure requirements and antifraud protections.[58] However, it took 50 years for the SEC to respond to calls that the 1933 Act and subsequent laws extended too far and kept many small businesses out of the markets.[59] In 1982, the SEC adopted Regulation D, and the SEC's main policy aim in adopting Regulation D was to "facilitate capital formation consistent with the goal of investor protection under the 1933 Act."[60]

The JOBS Act's stated goal was "to increase American job creation and economic growth by improving access to public capital markets for emerging growth companies."[61] In showing his support for the JOBS Act, Congressman Pete Sessions viewed the amendments to Regulation D as alleviating a credit problem in the economy.[62] Thus, the focus of the JOBS Act and the changes to Rule 506 are to some extent conceptually different from that of the statutory and regulatory framework it is based on.

B. Division in the SEC

1. Views on the JOBS Act

The conflict between protecting investors and promoting small business capital formation at the highest levels of the SEC was on full display during the SEC rule making process in response to the JOBS Act. The SEC proposed the first set of post-JOBS Act regulation D rules in September of 2012, including an allowance for general solicitation in rule 506 offerings to a group of only accredited investors that the issuer has taken reasonable steps to verify.[63] These fairly straightforward rules took almost a year to be finalized, and the only major change to the Rule 506 exempted offering was the inclusion of a non-exhaustive list of ways for an issuer to verify that an investor is accredited.[64]

SEC Chair Mary Jo White acknowledged these competing interests when the SEC began considering how to implement the JOBS Act's call for change to Regulation D. The JOBS Act had mandated SEC action 90

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[58] Securities Act, *supra* note 9.
[59] *See* Warren, *supra* note 10.
[60] *Id.* at 358.
[61] Jumpstart Our Business Startups Act of 2012, Pub. L. No. 112-106, 126 Stat. 306 (2012).
[62] 158 CONG. REC. H1222, 1223-24 (daily ed. March 7, 2012) (statement of Rep. Pete Sessions).
[63] Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, 77 Fed. Reg. 54,464, 54,465 (Sept. 5, 2012)(to be codified at 17 C.F.R. pts. 230 and 239).
[64] Eliminating the Prohibition, *supra* note 22, at 44,780.

days after enactment in April 2012, but did not propose any rules until September. In early July of the following year, White noted the passage of the deadline and called the SEC to act on the proposed rules.[65] However, she still was unsure about how to go about the issue noting widespread concerns about "whether the Commission can and should defer lifting the general solicitation ban while we pursue and adopt related discretionary rulemaking designed to provide more investor protections in this new market."[66] White believed that investor protection was important enough to warrant what amounted to a dual mission of promulgating rules to open the markets to small business and forming other rules on top of them to protect investors.[67]

Not all of the SEC Commissioners shared White's view that this dual purpose was necessary or even prudent. In September 2014, Commissioner Daniel M. Gallagher characterized the some of the SEC's proposed rules in response to the JOBS Act mandate as undoing some of the benefits in the statute and imposing new burdens on exempted transactions.[68] Gallagher's critical remarks rested on his foundational belief that enhancing small business's access to capital was the primary and overriding concern.[69]

On the same day that this first set of rules was finalized in late July 2013,[70] the SEC proposed a second round of changes to Rule 506. The main thrust of these rule changes was a much more involved disclosure system surrounding Rule 506(c) offerings by necessitating certain disclosures before and after the offering, as well as the inclusion of

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[65] Mary Jo White, Chair, Sec. & Exch. Comm'n, Statement at the SEC Open Meeting (July 10, 2013).

[66] *Id.*

[67] White almost seemed compelled against her judgment to act:

> In my view, given the explicit language of the JOBS Act as well as the statutory deadline that passed last July, the Commission should act without any further delay. This does not mean, however, that the Commission should not take steps to pursue additional investor safeguards if and where such measures become necessary once the ban on general solicitation is lifted.
> *Id.*

[68] Daniel M. Gallagher, Comm'r, Sec. & Exch. Comm'n, Speech: Whatever Happened to Promoting Small Business Capital Formation? (Sept. 17, 2014).

[69] *Id.*:

> I believe that the issue [small business representation in the legislative and regulatory process] warrants the agency's highest level of priority. . . . [T]he SEC has the ability to pursue meaningful reforms—both substantive and procedural—that could significantly improve small business capital formation. Hopefully, someday we actually will, unprompted by Congress.

[70] *See Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings: A Small Entity Compliance Guide*, SEC, http://www.sec.gov/info/smallbus/secg/general-solicitation-small-entity-compliance-guide.htm (last modified Sept. 20, 2013).

certain information in all solicitation and advertising materials.[71] The stated goal of the SEC in proposing these rules was "to address investor protection concerns arising from the ability of issuers, including private funds, to generally solicit for their Rule 506(c) offerings."[72] Thus, it appeared that the concern for protecting investors had found a response to the thrust of the JOBS Act.

Indeed, many on the SEC staff lauded the proposed changes. SEC Commissioner Elisse B. Walter stated her belief that these proposed investor protections were a necessary response to the just passed rules, and "the Commission needs to move forward with these proposals."[73] Commissioner Luis A. Aguilar expressed a similar view, but he felt that investor protections were even more necessary. Aguilar stated, "I'm afraid that any protections resulting from today's proposal will come too late, if they come at all, for many investors. . . .Investors should not be at risk any longer than is necessary."[74] Support for the rules seemed to be lining up behind the goal of protecting investors.

However, other Commissioners were not persuaded by the calls for increased investor protections. Commissioner Troy A. Paredes dissented from the proposed rules because "the proposal provides for a regulatory regime that would unduly burden and restrict the capital formation process."[75] Commissioner Gallaher also dissented from the proposed rules because of the possibility for increased regulation to undermine the entire private market system.[76] These dissenting Commissioners based their views on the belief that increasing regulation to cover a problem that had not yet materialized was overstepping the bounds of the SEC and would unduly burden businesses seeking an exempted offering by forcing them to comply with a range of requirements that to a certain extent undermined the reason for the initial JOBS Act reforms.[77]

The passage of these proposed rules did not face a

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[71] Amendment to Regulation D, Form D and Rule 156, 78 Fed. Reg. 44,806, 44,806 (July 24, 2013).
[72] *Id.* at 44,821.
[73] Elisse B. Walter, Comm'r, Sec. & Exch. Comm'n, Opening Remarks Regarding the Adoption of Rules Eliminating the Prohibition Against General Solicitation, the Adoption of Rules Regarding Disqualification of "Bad Actors" from Rule 506 Offerings (July 10, 2013).
[74] Luis A. Aguilar, Comm'r, Sec. & Exch. Comm'n, Statement at Open Meeting (July 10, 2013).
[75] Troy A. Paredes, Comm'r, Sec. & Exch. Comm'n, Statement at Open Meeting Regarding Final Rules Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings; A Final Rule Disqualifying Felons (July 10, 2013).
[76] Daniel M. Gallagher, Comm'r, Sec. & Exch. Comm'n, Statement at Open Meeting Regarding Proposed Amendments to Regulation D, Form D and Rule 156 under the Securities Act (July 10, 2013).
[77] *Id.*; Paredes, *supra* note 75.

congressionally mandated deadline, and no further official action has been taken as of August of 2015. The comment period for these proposed rules was to end on September 23, 2013. However, the SEC had received comments long past this deadline.[78] For instance, Commissioner Michael S. Piwowar noted a meeting between certain Commission staff and two lobbying groups to discuss Regulation D rulemakings on November 24, 2014.[79] Thus, the debate continued for over a year past the original deadline. The comments ranged from a group of six senators lauding the proposed changes,[80] to an open letter sent by 49 people advocating for a scaled back version of the rules,[81] to a group of four members of Congress harshly criticizing the proposed rules.[82] In total, there were hundreds of comments from lawmakers, business leaders, investor groups, and individuals that spanned the spectrum of ideals and positions.[83]

2. Uncertainty of Demo Days

The debate within the SEC was not always as polarized on the topic of general solicitation. For instance, confusion reigned when the discussion turned to demo days. Shortly before the changes of the JOBS Act went into effect, the SEC Advisory Committee on Small and Emerging Companies held an open meeting to discuss many of the upcoming changes and what the effects would be. The first question that arose following the opening remarks was whether demo days were covered under the guidelines of general solicitation through the use of the word seminar in the second example of 502(c).[84] Catherine Mott, a member of the advisory committee and a former Chairman of the Angel Capital Association, asked the question, and the confusion that followed

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[78] In fact the volume of comments was so great, the SEC extended the comment period for a little over a month. Amendment to Regulation D, Form D, and Rule 156; Re-Opening of Comment Period, 78 Fed. Reg. 61,222, 61,2222 (proposed Oct. 3, 2013).

[79] Memo from the Office of Comm'r Michael S. Piwowar to File Nos. S7-09-13 & S7-06-13 (Nov. 24, 2014).

[80] Letter from Senators Martin Heinrich, Carl Levin, Tom Harkin, Mark Pryor, Jeff Merkley, and Angus King to Chairman Mary Jo White (June 28, 2013), http://www.sec.gov/comments/s7-06-13/s70613-1.pdf.

[81] *Letter Type A on File No. S7-06-13*, SEC, http://www.sec.gov/comments/s7-06-13/s70613-48.htm (last modified Aug. 14, 2013).

[82] Letter from Congress members Steve Israel, Timothy Bishop, Peter King, and Carolyn McCarthy to Chairman Mary Jo White (May 8, 2014), http://www.sec.gov/comments/s7-06-13/s70613-503.pdf.

[83] *See* Comments on Proposed Rule: Amendments to Regulation D, Form D and Rule 156 Under the Securities Act, SEC, http://www.sec.gov/comments/s7-06-13/s70613.shtml (last modified Mar. 04, 2015)

[84] *SEC Advisory Committee on Small and Emerging Companies Open Meeting*, SEC (Sept. 17, 2013, 9:30 AM), http://www.sec.gov/info/smallbus/acsec/acsec-transcript-091713.pdf, at *0041.

highlighted the issue that demo days cause to the SEC for Regulation D.

The acting chief counsel for the SEC Division of Finance noted that, since neither demo days nor general solicitation are fully defined in the rules, a bright line answer for whether demo days are general solicitation did not exist and the determination would be made on the facts and circumstances.[85] Mott pushed for clarification on the issue, since "there are thousands of demo days and venture fairs."[86] The SEC Director of Corporate Finance put forth the view that someone must have concluded that demo days were not general solicitation, or else they would not have been permitted under the then current rules.[87] However, according to another advisory committee member, who was also the Securities Commissioner for the State of Arkansas, every demo day violated the rules, but the SEC just watched instead of acting because they are most often sponsored by a state government agency or effectively the governor's office.[88] Nevertheless, none of the individuals present at the open meeting were able to come to any understanding besides agreeing that it was a tricky issue. It is clear that something must be done to try to bring some clarity.

IV. PROPOSED CHANGES

A. The Difficulty of Reaching a Balance

The changes to Rule 506 that have been made or proposed in recent years raise two preliminary questions. First, with the recent growth of the market, are further developments even necessary? Second, to what extent is reaching a balance between promoting small business capital formation and protecting investors even possible?

For the first question, the answer seems to be past growth does not preclude further action to protect the advances and propel further activity in the market. Indeed the JOBS Act changes came on the heels of three years of relatively high levels of exempted offering activity. Given the focus on small business growth as a way to stimulate the

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[85] *Id.* (quoting Jonathon A. Ingram).
[86] *Id.* at *0041-42 (statement of Catherine V. Mott).
[87] *Id.* at *0042 (statement of Keith Higgins).
[88] *Id.* at *0042-43 (statement of A. Heath Abshure).; This argument really raises the question of federal and state authority over the securities markets. Demo days are not necessarily for offerings that are exempt from state blue sky laws, but the numbers show the disparity in the type of offerings used and the favoritism that is placed on 506(b) and (c), in part, due to their exemption from state securities law. If Mr. Abshure's remarks are correct, then state governments are aiding issuers and investors in violating the federal rules. However, if demo days are not a violation of the ban on general solicitation, then his views are incorrect and further action may not be necessary. Either way, the confusion is the main problem, and the SEC has demonstrated an inability to provide clarity or consistency to the issue.

economy, the reasoning to attempt to expand the market becomes clear.

The second question is harder to answer, but looking at the already proposed rules and legislation shows that no single option will quickly fix the system to the satisfaction of everyone. The debate surrounding demo days provides a good context to consider the two main aspects of the current rules that require careful consideration: the investor accreditation standards and the guidelines of general solicitation.[89]

B. Accreditation Standards

The accreditation standards in Rule 501(a) are not above reproach;[90] the SEC Investor Advisory Committee has recommended a number of changes that have yet to turn into finalized rules.[91] Indeed, in requiring issuers to take reasonable steps to verify the accreditation status of potential investors, the new standards of Rule 506(c) fully embrace one of the most controversial aspects of the whole Regulation D exemption structure, since meeting these standards is now the key for issuing securities to the widest pool of investors and engaging in general solicitation.

The accredited investor standard is based on the concept of identifying persons who "can bear the economic risk of an investment in unregistered securities, including the ability to hold unregistered (and

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[89] The current conflict over the Rule 506 exemptions should be considered within the entire framework of Regulation D. The historic discrepancy between Rule 506 offerings and those under Rules 504 and 505 is considerable and hints at a larger problem within Regulation D generally. *See* Ivanov and Baugess, *supra* note 3, at 4; *see also* Rutherford B. Campbell, Jr., *The Wreck of Regulation D: The Unintended (and Bad) Outcomes for the SEC's Crown Jewel Exemptions*, 66 BUS. LAW 919, 931–33 (2011). This inequity can be traced to Congress's and the SEC's unwillingness to remove offerings under Rules 504 and 505 from state blue sky laws, as the requirement to comply with state securities laws creates an immense expense to capital formation under these two exemptions. *Id.* (discussing prior attempts at legislative change that have failed). However, Congress expanded the scope of Rule 506 with the JOBS Act rather than addressing the disparate use of the exemptions. It remains to be seen whether Congress or the SEC will take on this issue, or if it is even considered an issue outside of academic debate. Although interesting, the issue is beyond the scope of this paper.

[90] *See, e.g.*, Larissa Lee, *The Ban Has Lifted: Now is the Time to Change the Accredited-Investor Standard*, 2014 UTAH L. REV. 369, 381 (2014)(discussing the insufficiency of the accredited investor standard).

[91] *See generally* INVESTOR ADVISORY COMMITTEE, SEC, RECOMMENDATION OF THE INVESTOR ADVISORY COMMITTEE: ACCREDITED INVESTOR DEFINITION (2014) (providing recommendations ranged from evaluating the efficacy of the current standards, to adding a sophistication aspect to the accreditation standard, to limits on how much an accredited investor could invest, to shifting the burden from the issuer verify accreditation).

therefore less liquid) securities for an indefinite period, and, if necessary, to afford a complete loss on the investment."[92] The concept was "intended to eliminate the need for subjective judgments by the issuer about suitability, because investors that met the definition of accredited investor would be presumed to meet the purchase qualifications."[93] However, the assumption of eliminating subjective judgments by the issuer comes into question in the context of 506 offerings in both 506(b) because of the knowledge aspect and 506(c) because of the verification requirement.

The accreditation standards have been questioned for their reliability,[94] as well as for their usefulness entirely because they are based solely on an investor's wealth and assets.[95] One commentator identified four main areas of protection for investors ion the context of private offerings: 1) fraud, 2) an unleveled informational playing field, 3) the extraction of private benefits from the firm by firm insiders, and 4) investors' propensity to make unwise investment decision.[96] Thus, much of the focus is on the information and experience that a potential investor has, whereas the bulk of the current accreditation standards are instead based on economic factors of the investor.[97] However, for certain purposes the Code of Federal Regulations acknowledges that it is the informational aspect, rather than the economic, that warrants consideration.

The main draw of accreditation status in a 506(b) offering is that these investors are not counted against the limit on the number of purchasers. However, accredited investors also are not subject to the informational requirement of 506(b), which requires non-accredited investors to have "such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment. . . ."[98] Furthermore, the purchaser need not be the one with the informational basis. A purchaser can satisfy this requirement by retaining a purchaser representative who by definition meets the requirement.[99] Thus, the informational component acts in conjunction with the accredited investor standards, but only for the purpose of who can purchase in a 506(b) exempted offering.

Since the informational requirement operates only for non-accredited purchasers under 506(b), it appears that the accreditation

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[92] Net Worth Standard For Accredited Investors, *supra* note 20, at 4.
[93] *Id.* at 4 n.17.
[94] Michael D. Guttentag, *Protection From What? Investor Protection and the JOBS Act*, 13 U.C. DAVIS BUS. L.J. 207, 250 (2013).
[95] Lee, *supra* note 90.
[96] Guttentag, *supra* note 95, at 210.
[97] 17 C.F.R. § 230.501(a) (2013).
[98] *Id.* § 230.506(b)(2)(ii).
[99] *Id.*; *id.* § 230.501(i).

standards are meant to cover this informational condition by proxy. The SEC itself said that it was comfortable with keeping the sophistication standard in 506(b) when it set forth the verification in 506(c).[100] However, it is not clear whether this is actually the case, and this is the crux of the arguments in favor of changing the accredited investor standards. One of the proposed changes is to create a hybrid requirement that combines the accreditation wealth and asset floors with the sophistication standards in order to offer better protection that more accurately reflects the goals of Congress and the SEC.[101]

Rather than embrace the informational aspect of 506(b), the SEC moved in a different direction with 506(c) through a new requirement that the issuer must take reasonable steps to verify the accreditation status of the prospective purchasers.[102] This means that the new requirement not only embraces the accredited investor standards, but it goes further to make the accredited investor standards the sole form that a purchaser can utilize to engage in an offering. The difference between the accredited investor standard and the informational standards in 506(b), and the imposition of a requirement to reasonably attempt to verify the accreditation status of investors in 506(c), shows that the SEC is more willing to embrace the current accredited investor standards than to seek a new rule that encompasses the multitude of ways that an investor needs protection and can protect themselves.

The SEC did not prescribe the ways that an issuer must verify the accreditation status of potential purchasers in a 506(c) offering. Rather, the SEC wanted to allow issuers the flexibility to decide how best to verify by enumerating a non-exhaustive list of methods in the rule.[103] For instance, an issuer can review certain financial documents of the purchaser, obtain a letter from specific people or entities who themselves have taken reasonable steps to verify the accreditation status of the purchaser, or obtain an accreditation certification from the purchaser if the purchaser was involved in an offering of the same issuer prior to the enactment of the new rules.[104]

Thus, these methods of verification not only require issuers to take action, but they also force potential purchasers to possibly disclose more information to issuers than previously required. This possibility of disclosure is what galvanized certain investors to action and led to the introduction of the Helping Angels Lead Our Startups (HALOS) Act in

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[100] Eliminating the Prohibition, *supra* note 22, at 18.
[101] Lee, *supra* note 90, at 386–87 (explaining that proposed accreditation standard is a mix of financial sophistication through certification, education or experience, wealth verification similar to the current rule, investment diversification requirements); Guttentag, *supra* note 95, at 255–57.
[102] 17 CFR § 230.506(c)(2)(ii) (2015).
[103] *Id.* §§ 230.506(c)(2)(ii)(A)–(D).
[104] *Id.*

both the House and the Senate in the summer of 2014.[105] The HALOS Act attempts to deal with the disclosure issue created in 506(c) by altering the guidelines for general solicitation to allow limited a limited form of solicitation through demo days while remaining under 506(b), which would also then subject the offering to the more lenient accreditation checks contained therein.[106]

C. The HALOS Act

The HALOS Act was introduced into the House and Senate in June 2014.[107] It proposed to piggyback on the allowance for general solicitation under 506(c) by restricting the guidelines of general solicitation to not include demo days for angel investors. Demo days are defined in the proposals as events that are sponsored by select groups where the advertising for the event does not reference any specific offering by an issuer, the sponsor of the event is limited in its role, and potential issuers are restricted in the type and amount of information that they can give out. The HALOS Act was a response to uncertainty in the investment community about the legality of demo days, which had previously existed without issue under 506(b), under the new regulatory framework that included 506(c).[108] Senator Chris Murphy, one of the HALOS Act's sponsors, introduced the legislation for the dual purpose of promoting startup companies by insuring that the small businesses do not have to comply with more rigid accredited investor verification requirements of 506(c) and assuring investors that their ability to get involved with these small businesses will not be inhibited by unnecessary intrusions into their status.

The main argument presented in favor of the HALOS Act is that the policy goal of promoting small business capital formation is only possible when capital markets are open to as broad a range of investors

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[105] *See, e.g.*, Helping Angels Lead Our Startups (HALOS) Act, H.R. 4915, 113th Cong. (2013).

[106] *Id.*; 17 C.F.R. § 230.506(b)(2013) (issuer must just reasonably believe that the investor is accredited).

[107] Helping Angels Lead Our Startups (HALOS) Act, H.R. 4915, 113th Cong. (2013).

[108] *See* Chris Murphy, *Helping Angels Lead Our Startups (HALOS) Act*, SENATE, http://www.murphy.senate.gov/download/halos-act (last visited Mar. 5, 2015); *see also* Alon Y. Kapen, *Will Your Demo Day Presentation Violate the Securities Laws?*, N.Y. VENTURE HUB (Aug. 11, 2014), http://www.nyventurehub.com/2014/08/11/will-your-demo-day-presentation-violate-the-securities-laws/; James Johnson, *What Happens to Demo Days in the New Era of General Solicitation?*, FIRST VENTURE LEGAL (Oct. 15, 2013), http://www.firstventurelegal.com/what-happens-to-demo-days-in-the-new-era-of-general-solicitation/; Trent Dykes, *Demo Days, Pitch Events, and the New Reg D*, VENTURE ALLEY (Sept. 23, 2013), http://www.theventurealley.com/demo-days-pitch-events-and-the-new-reg-d/.

as possible, and, at least in this limited situation, the verification of an investors accreditation status places onerous obstacles to investor involvement.[109] The focus is on the actions that a potential investor must take rather than on what the issuer must do. This argument highlights the dual nature of the small business capital formation problem. Not only do business need access to the market, but they need investors that are willing to engage in the transaction. A delicate balance must be struck with investor protection mechanisms. If the protections are too lenient investors are vulnerable to a host of fraud and deception issues; however, if protections are too strict, then the market may incentivize investors to not engage in the transaction at all.

In the midst of the rampant uncertainty and speculation, the HALOS Act attempts to settle the issue. Investors often wrestle with the uncertainty of whether a business will create a return, but this is only possible when there is some form of certainty in the structural system in place that controls these investments. Catherine Mott, the SEC Advisory Committee on Small and Emerging Companies Member, saw two ways to address the problem: either the SEC must "define general solicitation more clearly so entrepreneurs are very clear what they have to do, or carve out demo days and venture fairs."[110] Given the SEC's apparent lack of willingness, or even the knowledge, to act, it seems that Congressional action through the HALOS Act may be the only way to generate the certainty that entrepreneurs and angel investors need to effectively invest and generate capital.

Thus the HALOS Act is designed to remedy two issues that certain investors have with Rule 506(c): 1) the possible increased disclosures from investors so that issuers can verify their accreditation status, and 2) the uncertainty of whether demo days are within the definition of general solicitation. By explicitly removing certain demo days from the guidelines of general solicitation, the HALOS Act offers guidance on how to structure events to avoid an unintended 506(c) classification.[111] An extension of the event not being general solicitation is that the issuers do not have to verify the accreditation status of the investors, so the investors do not have to possibly disclose personal information in order to take part in the offering.

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[109] *See Murphy Introduces Bipartisan Jobs Bill to Support Startups, Small Businesses*, SENATE (June 19, 2014), http://www.murphy.senate.gov/newsroom/press-releases/murphy-introduces-bipartisan-jobs-bill-to-support-startups-small-businesses.

[110] Dave Michaels, *U.S. Startups Freed to Solicit Funds Fight SEC Over Disclosures*, BLOOMBERG (Sept. 23, 2013, 12:01 AM), http://www.bloomberg.com/news/2013-09-23/u-s-startups-freed-to-solicit-funds-fight-sec-over-disclosures.html.

[111] Helping Angels Lead Our Startups (HALOS) Act, 113 H.R. 4915, 113th Cong (2013).

While the HALOS Act does seem to definitively deal with some of the issues that have been raised in response to the new rules surrounding 506, a question arises of whether the best route to deal with the problem is through legislation that is as narrowly tailored as the HALOS Act. The SEC's actions shows that some form of legislation is likely required, but the uncertainty of Congress and the more general confusion surrounding 506 and Regulation D indicates that a piecemeal approach may not be ideal.

D. General Solicitation

The general solicitation guidelines in Regulation D rely on breadth with SEC and staff interpretations to fill in the gaps. This is typical, more or less, for much of the Federal securities structure. However, the overriding focus on flexibility is hurting issuers in the context of private offerings where some issuers can engage in general solicitation while others can't. The confusion over demo days is just one example at how the extremely limited examples given for general solicitation do not provide all of the necessary information. Many in the press and those on the SEC remain unsure of where the line is for general solicitation and demo days, even though the SEC staff issued a no-action letter in 1995 to the Michigan Growth Capital Symposium in which the staff put forth some key factors in deciding that presenting companies at the symposium would not be deemed to have generally solicited.[112] Among the factors that the SEC staff considered in reaching this determination was that the symposium arranged no prior contact between presenters and attendees, no specific financing details were part of the presentations, and no private placement materials were distributed at the symposium.[113] Thus, there has been almost 20 years for issuers, investors, and the SEC to come to a better understanding of the situation, and it is clear from the confusion that no one has been able to.

The main focus of the SEC, judged by the proposed rules, appears to focus on disclosures and forms related to the offering and the general solicitation materials used.[114] The focus on disclosures and forms is not bad in and of itself, but it seems premature if an issuer does not have the information it needs to make the decision of whether or not to engage in general solicitation. Amending the current general solicitation framework on an appreciable level can be undertaken by the SEC unilaterally or through Congressional action such as the HALOS Act. Both avenues pose distinct problems in gaining the necessary consensus

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[112] Michigan Growth Capital Symposium, SEC No-Action Letter, Fed. Sec. L. Rep. 77,052 (May 4, 1995).
[113] *Id.*
[114] *See infra* Parts II.A–B.

to put the changes into effect. Congressional action seems to be the more possible form of change given the focus of the SEC on other aspects of Regulation D, not to mention everything else the SEC must deal with. However, no matter how it comes about, something must be done.

Whether the SEC unilaterally acts pursuant to its rule making authority, updated guidelines of general solicitation can realistically take one of two forms. Either general solicitation can be fully defined in the rules, or the current non-exclusive list can be expanded to provide a greater understanding to what is considered general solicitation. Both options offer a degree of clarity that is not currently present in the rules. While a comprehensive definition of general solicitation would offer issuers and investors with the greatest certainty as to what falls within the reach of the rules, the SEC would lose out on the flexibility it currently has in applying the rules and dealing with unique situations. Conversely, an expansion of the current guidelines, especially if done primarily with demo days in mind, may result in an ever-evolving definition as new issues arise.

A comprehensive definition is more of a deviation from the current structure than is really necessary. The issue does not warrant a complete abrogation of the current framework because although the uncertainty generated by demo days is evident, they are just a single part of the private placement apparatus. However, demo days do warrant consideration for creating a new form of exception to the general solicitation framework that can serve as a basis and an example for future situations that arise that are not readily dealt with through the SEC's less formal processes such as no-action letters.

The first part of 17 CFR 230.502(c)(2) does not necessarily require updating, as it merely extends the prohibitions in 502(c)(1) to how attendees are invited to a meeting or seminar. The main issue with 502(c)(2) lies in the exceptions that are set out in the rest of the paragraph. This is not to say the current exceptions pose a problem, but they too are insufficient in the current landscape. The HALOS Act offers a prime example of the type of limited and situation based exception that would begin to mold the general solicitation definition into something that issuers, investors, and the SEC staff can rely on. This is not to say that the language promoted by the HALOS Act is the only or best change, but it fully embodies the structural shift that must take place since the distinction between general solicitation and not plays so heavily in the distinction between 506(b) and 506(c).

Further exceptions to the general solicitation framework, especially one related to demo days, must depart from the nature of the current exceptions. This is because an exception for demo days cannot be based on filings or compliance with other aspects of securities regulation. Thus, the definition to general solicitation must embrace a new form of

exceptions, ones that are based on current practice rather than on prior laws and regulations.

The main difference between an exception to the general solicitation definition for demo days and the additional rules that the SEC has proposed but not yet adopted is whether demo days are explicitly kept under 506(b) or kept in limbo between 506(b) and a then more onerous 506(c). Given their widespread use, and at least tacit acceptance, under 506(b), the definition of general solicitation should be amended to create certainty in this area. By explicitly keeping demo days under 506(b), issuers can tailor their actions to maintain access to this important source of capital, and investors can be protected from issuers that may take advantage of the uncertainty.

Outside of the context of demo days, a small change to the general solicitation examples rather than the exceptions could be useful to further clarify general solicitation in a way that is consistent with past interpretations.[115] Even though the SEC had electronic media in mind when it created 506(c),[116] the current definition only explicitly covers materials that are published or broadcast through what seems to be print media, television, or radio. While a newspaper that is published in an online format may seem to fall under this definition, something like a social media post does not seem to be covered by the existing standard. Thus, the modernization of the general solicitation definition must not only cover the current trends of internet communication, but also be adaptable to future technological advancements in how people disseminate information.

> For instance, 17 CFR § 230.502(c)(1) can be rewritten as:
>
> Any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio or disseminated over the internet for public consumption.

The inclusion of "for public consumption" fits with the connotation of the words publishing and broadcasting as they are currently used in the definition. More than merely writing the ideas or verbalizing them, publishing and broadcasting invoke the idea of spreading the information to the population. Therefore, the inclusion of the internet as a medium for transmitting solicitation must similarly be tailored to fit the meaning of the regulation as it is currently written.

The relatively minor change to the examples portion of the

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[115] *See* Use of Electronic Media, *supra* note 33; IPONET, *supra* note 39; Eliminating the Prohibition, *supra* note 22.

[116] Eliminating the Prohibition, *supra* note 22, at 81.

general solicitation framework, and the tonal shift brought into the exceptions section serves to put the decision of what private placement rule to follow fully in the hands of an issuer. An issuer should not be forced to use one rule out of fear that it will inadvertently violate an unclear provision of another, especially when the rule is predicated on helping small businesses get access to the capital that they need to survive.

V. CONCLUSION

The struggle over how to deal with demo days highlights the incredible connectivity of every part of Regulation D. Uncertainty in who is an accredited investor and how that status can be verified by issuers may lead to fewer 506(c) offerings to avoid the issue. Conversely, the ambiguity of the definition of general solicitation may cause issuers to more fully embrace 506(c) offerings to avoid the anxiety over what they can and cannot say to potential investors. Thus, even small changes to the general solicitation guidelines or the accredited investor standards can lead to a major impact on how everyone involved interacts with the entire Regulation D structure.

It took almost 50 years for the SEC to adopt a more centralized exempted offering structure, and another 30 years after that to start opening up at least part of the process to target a wider pool of available capital. Throughout this entire time period vast amounts of money have been raised, and the SEC has continuously interacted with the system to balance investor protection with keeping these markets thriving. Updating the accredited investor standard and the general solicitation guidelines is just another step in this process, and, compared to creating Regulation D, a small one.

The alterations proposed here are more about tone than specific substance. A knowledge component to the accreditation standards, and situational updates and exceptions to the general solicitation definition can come in a variety of ways. The symbiotic nature of the accredited investor standards and the general solicitation guidelines means that altering one side must be balanced by alterations on the other. The way that they are then used by issuers and investors and the gloss that the SEC staff puts over them through their own interpretations will continue to form and shape any official rule or regulation that is passed. The key is to proactively engage with the problem rather than allowing uncertainty to reign. Although it can seem beneficial to pursue some sort of operational flexibility in the haze, neither the goals of investor protection nor of promoting capital formation would be served.